

return. The Commission proposes to allow all carriers providing Section 272 services (either directly or indirectly through an affiliate) to use a uniform rate of return to value affiliate transactions.⁵⁰ U S WEST does not agree with this proposal. Rather, the Commission should permit any LEC to determine the return component of affiliate transaction costs using a composite of the prescribed interstate rate of return and the intrastate rates of return prescribed or authorized for that LEC. U S WEST uses a composite rate represented by the weighted average of the authorized interstate and intrastate rates of return for all jurisdictions in which U S WEST Communications, Inc. ("USWC") operates. This approach recognizes that transactions between USWC and the affiliates benefit both the interstate and intrastate services that USWC provides to third parties.

3. Application to InterLATA Telecommunications Affiliates

The Commission proposes to apply its affiliate transactions rules to transactions between a BOC and any interLATA telecommunications services affiliate the BOC establishes under Section 272(a).⁵¹ The Commission acknowledges that interLATA telecommunications services are normally classified as regulated for Title II accounting purposes, and the existing affiliate transactions rules are designed solely for transactions between regulated carriers and nonregulated affiliates.⁵²

⁵⁰ NPRM ¶ 87.

⁵¹ Id. ¶ 89.

⁵² Id.

U S WEST believes that the Commission should treat interLATA services provided through a separate affiliate as non-regulated for Title II accounting purposes, and should apply its current Part 32 affiliate transactions rules.

4. Application to Joint Marketing

Section 272(g)(2) allows the BOC to market or sell interLATA service provided by a Section 272 affiliate after the BOC is authorized to provide interLATA services in a particular state.⁵³ The Commission is considering in a separate proceeding whether an affiliate may share marketing personnel with a BOC.⁵⁴ If an affiliate may share marketing personnel with a BOC, the Commission tentatively concludes that it should apply its cost allocation and affiliate transactions rules, as modified, to any joint marketing of interLATA and local exchange services.⁵⁵ U S WEST agrees, except that U S WEST does not support some of the proposed modifications.⁵⁶

⁵³ 1996 Act, 110 Stat. at 94 § 272(g)(2).

⁵⁴ In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended; and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, CC Docket No. 96-149, Notice of Proposed Rulemaking, FCC 96-308, rel. July 18, 1996, ¶ 62 (1996).

⁵⁵ NPRM ¶ 91.

⁵⁶ See supra Section IV(A)(2)(a).

B. Electronic Publishing (Section 274)

1. Accounting Issues

U S WEST sees no basis for different accounting treatment of affiliate transactions pursuant to Sections 272 and 274. The Commission should apply its existing affiliate transaction rules to transactions between a BOC and its electronic publishing joint venture or separated affiliate. Application of these rules would provide adequate accounting safeguards for the joint activities permitted under Section 274(c)(2).⁵⁷ The rules laid down by Congress are sufficient to protect against cross-subsidization; no additional accounting, bookkeeping or record keeping requirements for these affiliates and joint ventures are needed.⁵⁸ Moreover, there is no reason to distinguish, for Title II accounting purposes, between transactions involving a BOC and its “separated affiliate” and those involving a BOC and its electronic publishing venture.⁵⁹

2. Independent Operation

Section 274(b) requires that the separated affiliate or joint venture operate independently, and that the BOC with which it is affiliated must “carry out transactions (A) in a manner consistent with such independence, (B) pursuant to

⁵⁷ NPRM ¶ 105.

⁵⁸ Id. ¶ 109.

⁵⁹ Id. ¶ 105.

written contracts or tariffs that are filed with the Commission and made publicly available, and (C) in a manner that is auditable in accordance with generally accepted auditing standards.”⁶⁰ U S WEST contends that no regulations are necessary to implement the independent operation requirement. Congress clearly communicated the requirements in Sections 274(b)(1) - (9). Nor is it necessary for the Commission to amend its rules to implement the requirement that transactions be auditable in accordance with generally accepted auditing standards. As the Commission acknowledges in the NPRM, the term “generally accepted auditing standards” has a well-defined meaning and no further explanation or embellishment is needed.⁶¹

3. Reporting Requirements

Section 274(f) requires the filing with the Commission an annual report similar to the SEC’s Form 10-K. U S WEST has an existing non-regulated affiliate that includes directory operations. Electronic publishing is a line of business within this affiliate. While U S WEST does not file a 10-K for the affiliate, the 10-K U S WEST files for its consolidated operations includes directory information. The Commission’s rules should permit U S WEST to satisfy the Section 274(f) reporting requirement by filing its 10-K with the Commission. The benefits of providing more

⁶⁰ 1996 Act, 110 Stat. at 100 § 274(b)(3).

⁶¹ NPRM ¶ 111.

detailed and extensive information about U S WEST's electronic publishing operations would be outweighed by the costs.

4. Provision of Network Access and Interconnections for Basic Telephone Service

Section 274(d) also requires a "Bell operating company under common ownership or control with a separated affiliate or electronic publishing joint venture . . . [to] provide network access and interconnections for basic telephone service to electronic publishers at just and reasonable rates that are tarified (so long as rates for such services are subject to regulation) and that are not higher on a per-unit basis than those charged for such services to any other electronic publisher or any separated affiliate engaged in electronic publishing."⁶² The Commission tentatively concludes that it should apply its affiliate transaction rules, as modified, "to the provision of 'network access and interconnections for basic telephone service'" by a BOC under common ownership and control.⁶³ U S WEST agrees, except it does not support some of the proposed modifications.⁶⁴

C. Other Separated Operations

Sections 260 (telemessaging), 271 (interLATA telecommunications), 275 (alarm monitoring) and 276 (payphone) of the 1996 Act define categories of services

⁶² 1996 Act, 110 Stat. at 102 § 274(d).

⁶³ NPRM ¶ 117.

⁶⁴ See supra Section IV(A)(2)(a).

that BOCs and, in some cases, incumbent LECs may not necessarily have to offer through a separate affiliate. The Commission believes that application of its affiliate transactions rules, with the proposed modifications, to transactions between an incumbent LEC and any of its affiliates engaged in activities that Sections 260, 275 and 276 of the 1996 Act might permit or require the carrier to offer through a separate affiliate would be consistent with the statutory mandates.⁶⁵ U S WEST agrees.

The Commission tentatively concludes that it should apply its affiliate transactions rules to transactions between each BOC and any interLATA telecommunications services affiliate it establishes because interLATA telecommunications services present a potential for improper subsidization.⁶⁶ U S WEST does not agree that interLATA services present a potential for improper subsidization. Under the Commission's recent Order in CC Docket No. 96-98, it is questionable whether the BOCs can even recover their costs.⁶⁷ The BOCs are not in any position to subsidize interLATA operations when their telephone exchange services are provided below cost. U S WEST agrees, however, that the Commission should apply its affiliate transactions rules to such transactions by treating the

⁶⁵ NPRM ¶ 118.

⁶⁶ Id. ¶ 119.

⁶⁷ In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket Nos. 96-98 and 95-185, First Report and Order, FCC 96-325, rel. Aug. 8, 1996.

interLATA affiliate as nonregulated for accounting purposes. There is no need for special valuation methodologies.

V. AUDIT REQUIREMENTS

The 1996 Act contains several audit requirements. Section 272(d) requires that an audit be conducted every two years by an independent auditor.⁶⁸ Section 274(b)(8)(A) requires electronic publishing “separated affiliates” or joint ventures and the BOC with which they are affiliated to have an annual compliance review conducted “by an independent entity for the purpose of determining compliance during the preceding calendar year.”⁶⁹ In each case, the Commission proposes to require the independent entity to prepare and file with the Commission reports describing: (1) the scope of the compliance review, “with a description of how the affiliate’s or joint venture’s books were examined and the extent of the examination,” (2) the independent entity’s “conclusion whether examination of the books has revealed compliance or non-compliance with the affiliate transactions rules and any other non-discrimination requirements imposed by Commission rules,” (3) any limitations imposed on the independent entity “in the course of its review by the affiliate or joint venture or other circumstances that might affect the entity’s opinion,” and (4) statements by the independent entity as to whether “the carrier’s accounting and affiliate transactions methodologies conform to the

⁶⁸ 1996 Act, 110 Stat. at 93 § 272(d).

⁶⁹ Id. at 101 § 274(b)(8)(A).

Communications Act of 1934, as amended, and the Commission's rules" and whether "the carrier has accurately applied the methodologies."⁷⁰

U S WEST agrees to have a separate biannual compliance audit in accordance with 272(d) and a compliance review in accordance with Section 274(b)(8). However, U S WEST recommends the Commission require the annual Part 64 audit be conducted biannually in an effort to streamline current regulations and reduce redundancy.⁷¹ If the Commission decides to go forward with its proposal, it should make it clear that auditors' workpapers and other confidential information will not be put on the public record.

VI. OTHER MATTERS

A. Price Caps

The Commission's price cap rules for incumbent LECs specify that "[s]ubject to further order of the Commission, . . . exogenous cost changes shall include cost changes caused by . . . [t]he reallocation of investment from regulated to nonregulated activities pursuant to [Section 64.901 of the Commission's rules]."⁷² The Commission seeks comment on a "strict reading" of this rule, whereby cost allocations due to changes in the Part 64 cost allocation process would result in exogenous treatment only to the extent amounts are reallocated "from regulated to

⁷⁰ NPRM ¶¶ 93, 106.

⁷¹ 1996 Act, 110 Stat. at 129 § 402.

⁷² 47 CFR § 61.45(d)(1)(v).

nonregulated activities.”⁷³ The Commission also seeks comment on whether all such reallocations of nonregulated activities that may result from the provision of telemessaging service should trigger an adjustment to lower price cap indices.⁷⁴

Exogenous treatment of nonregulated costs would not be in the public interest because it would penalize LEC use of common facilities for nonregulated services. Exogenous treatment, coupled with a LEC productivity adjustment, would constitute a “double-dip.” It is well-recognized that price cap regulation severs the tie between costs and prices. Once the rates for price cap services are established, prices are regulated by the price cap formula, not by the allocation of costs. That formula, based primarily on inflation and LEC productivity, has resulted in ongoing reductions in the Price Cap Index and rate reductions in each of the price cap baskets. Consequently, there is no incentive for price cap companies to misallocate nonregulated costs. Such a misallocation would not result in an increase in rates because those rates are already capped by the Price Cap Index.

The Commission also seeks comment on the potential exogenous treatment of new investment in network plant, some of which will be used for telemessaging service.⁷⁵ New investment for such nonregulated services should not be subject to exogenous treatment because new investment in the network for regulated services typically is not reflected in price cap rates and, thus, there should not be an adjustment for nonregulated services.

⁷³ NPRM ¶ 123.

⁷⁴ Id.

⁷⁵ Id.

In regard to the relationship between price cap sharing obligations and Part 64 processes, U S WEST believes that eliminating sharing obligations for price cap carriers would eliminate the need for Part 64 processes in the Commission's regulation of these companies. Accordingly, U S WEST recommends that the Commission eliminate Part 64 requirements in the price cap process if sharing is eliminated.

B. Universal Service (Section 254(k))

The Commission seeks comment on whether its proposals regarding Sections 260 and 271 through 276 of the 1996 Act are sufficient to implement the requirements of Section 254(k) that carriers not “use services that are not competitive to subsidize services that are subject to competition,” and that the Commission, “with respect to interstate services,” establish rules necessary to ensure that regulated universal services “bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.”⁷⁶ While U S WEST believes that the existing rules generally are sufficient to implement the Section 254(k) requirements, the Commission need not and should not decide this until the universal service reform proceeding is complete.

⁷⁶ Id. ¶ 125. And see 47 USC § 254(k).

VII. CONCLUSION

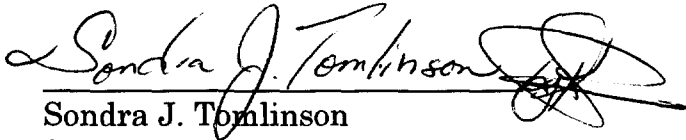
Changes to the Part 32 and 64 rules that would impose new requirements on carriers or deprive them of the flexibility they have enjoyed in the past are unnecessary and undesirable. Such changes would represent a new layer of redundant regulation at a time when the existing layers are supposed to be peeled away and finally eliminated. Several of the proposals in the NPRM are, therefore, ill-advised from a policy standpoint.

They are also unwise from a practical standpoint. No system is perfect. What exists today, however, is sufficient to meet the statutory requirements. The Commission should not underestimate the disruption and confusion that implementing new accounting safeguards would cause both the Commission and the parties subject to them. U S WEST urges the Commission to affirm the effectiveness of its current rules (as it has done many times in the past), apply them

to the services that will be provided pursuant to the 1996 Act (subject to streamlining and eventual phase-out), and move on to more important matters.

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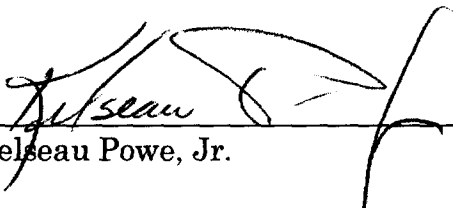
Its Attorney

Of Counsel,
Dan L. Poole

August 26, 1996

CERTIFICATE OF SERVICE

I, Kelseau Powe, Jr., do hereby certify that on this 26th day of August, 1996,
I have caused a copy of the **COMMENTS OF U S WEST, INC.** to be served via
hand-delivery upon the persons listed on the attached service list.



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